Section 22(f) of the Investment Company Act of 1940, 54 Stat. 824, as amended, 15 U.S.C. 80a–22(f), provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

STATEMENT

This is a direct appeal from a judgment of the district court dismissing prior to discovery or trial a civil antitrust action filed by the United States under Section 1 of the Sherman Act, 15 U.S.C. 1. The defendants are the National Association of Securities Dealers, Inc. ("NASD") and certain mutual funds,[1] mutual fund underwriters,[2] and securities broker/dealers.[3] The complaint alleged that the appellees have combined and agreed to restrict the sale and/or fix resale prices of the shares of open-end mutual

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[1] Massachusetts Investors Growth Stock Fund, Inc.; Fidelity Fund, Inc.; and Wellington Fund, Inc.

[2] The Crosby Corporation; Vance, Sanders & Company, Inc.; and The Wellington Management Company, Inc.

[3] Merrill Lynch, Pierce Fenner & Smith, Inc.; Bache & Company, Inc.; Reynolds Securities Corp.; F. I. duPont, Glore Forgan, Inc.; E. F. Hutton, Inc.; Walston & Company, Inc.; Dean Witter & Company, Inc.; Paine, Webber, Jackson & Curtis, Inc.; and Hornblower & Weeks—Hemphill, Noyes, Inc.

funds in transactions between dealers[4] ("the inter-dealer market") and in transactions between investors made through a broker ("the brokerage market") in violation of the antitrust laws.

THE MARKETS FOR OPEN-END MUTUAL FUND SHARES

This case involves alleged restraints on the trade and commerce in open-end mutual fund shares, an industry described in detail in the complaint (¶¶ 3, 9–14). A mutual fund is an investment company which invests in the securities of other corporations. An "open-end" company or fund is one which issues "redeemable securities," *i.e.*, common stock representing an interest in the assets of the fund, the owner of such stock or "shares" being entitled, on demand, to receive from the fund his proportionate share of the fund's current net assets or the cash equivalent thereof. See 15 U.S.C. 80a–2(a)(32).

Typically, in their initial or primary distribution, open-end mutual fund shares are distributed through a principal underwriter (often an affiliate of the fund) to dealers with whom the underwriter has sales agreements, and the dealers sell to investors. Under

[4] Under the Investment Company Act of 1940, a "dealer" is "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise * * *" (15 U.S.C. 80a–2(a)(11)), and a "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others * * *." 15 U.S.C. 80a–2(a)(6). The term "broker/dealer" is not defined in the Act but is used generically and applies to firms which engage in securities transactions in the capacity of either a "broker" or a "dealer."

Section 22(d) of the Investment Company Act of 1940 (15 U.S.C. 80a–22(d)), fund shares may be sold in this initial distribution to investors only at the "current public offering price." This price is equal to the prorated net asset value of the fund's portfolio plus a sales commission or "load," which is divided between the principal underwriter and the dealer.[5] An investor wishing to dispose of his shares normally does so by tendering them to the fund, which is obliged to pay him the proportionate current net asset value of his shares. Shares may also be redeemed through dealers.

A "secondary dealer market" in mutual fund shares includes an inter-dealer market and a market in which dealers purchase outstanding shares from investors, possibly at more than the redemption price, and resell to investors at the fund's "current public offering price." A "brokerage market" in mutual fund shares is one in which outstanding shares are transferred between investors acting through broker/dealers in a brokerage transaction.

Many aspects of the primary distribution of mutual fund shares are regulated by the Investment Company Act of 1940, 15 U.S.C. 80a–1, *et seq.* In addition, most broker/dealers are members of the defendant NASD, which is the only national securities association that has been registered with the Securities and Exchange Commission ("SEC") pursuant to the Maloney Act of 1938 (15 U.S.C. 78*o*–3). That Act authorizes such

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[5] Sales loads are typically between 7.5 percent and 8.5 percent of the offering price; 1.5 percent usually goes to the principal underwriter, with the balance going to the dealer.

a registered association to engage, by adoption and enforcement of rules, in a degree of self-regulation, subject to specified review by the Commission. The Maloney Act provides that its provisions prevail over any prior law in conflict therewith. 15 U.S.C. 78*o*-3(n). The Investment Company Act further provides that an association registered under the Maloney Act may adopt rules governing limited aspects of the distribution and redemption of mutual fund shares. 15 U.S.C. 80a-22(a), (b) (1).

B. THE ANTITRUST VIOLATIONS ALLEGED IN THE COMPLAINT

The complaint alleges in Count I that the appellee NASD and its members (including the appellee broker/dealers and underwriters) have combined and conspired to restrain trade in the purchase and sale of mutual fund shares through a conspiracy, "the substantial terms of which have been, and are, to prevent the growth of a secondary dealer market and a brokerage market in the purchase and sale of mutual fund shares" (Compl. ¶¶ 15-16).

Among the things appellees allegedly did to effectuate the conspiracy were to (a) establish and maintain rules which had the effect of inhibiting the development of the secondary dealer and brokerage markets; (b) induce broker/dealers and principal underwriters to enter into restrictive sales agreements designed to suppress the development of such markets; (c) distribute misleading information concerning the legality of a brokerage market and discourage persons

from participating in it; and (d) suppress market quotations for the secondary dealer market.

In addition, Counts II–VIII alleged that the appellee mutual funds and their principal underwriters and broker/dealers have "entered into and maintained contracts and combinations * * * in unreasonable restraint of the aforesaid trade * * *" (Compl. ¶¶ 22, 28, 34, 40, 46, 52 and 57), consisting of specific contractual agreements between the broker/dealers and principal underwriters ("sales agreements") and between the principal underwriters and their respective mutual funds ("underwriting agreements"). The sales agreements, the complaint alleged, contain restrictive provisions directed towards prohibiting the participation of the broker/dealer in competitively-priced brokerage or interdealer markets. The underwriting agreements were alleged not only to prohibit the principal underwriter from participating in transactions in the secondary markets, but also, in one instance, to obligate the principal underwriter to require that broker/dealers, in turn, agree to such restrictions.

In consequence, it is alleged, the purchase and sale of open-end mutual fund shares have largely been confined to the primary distribution system; secondary markets have been eliminated or curtailed;[6] where

[6] Although the record contains no evidence, due to the dismissal of the complaint, it is undisputed that as a practical matter no brokerage market exists currently and the interdealer market is insignificant, apparently having accounted for less than one-tenth of one percent of total share sales in 1970. SEC Staff Study. *On the Potential Economic Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* A-113 (1972).

secondary brokerage transactions have been permitted by certain funds, the prices at which such transactions occur have been illegally fixed; and the public has been deprived of the benefits of free and open competition in a secondary dealer market and a brokerage market in mutual fund shares.

The complaint seeks a variety of injunctive relief against continuation of the alleged violations and perpetuation of their effects.

C. THE DISTRICT COURT'S DECISION

On motions by the appellees filed before discovery and trial, the district court dismissed the government's complaint for failure to state a claim upon which relief could be granted.[7] First, the court held that "Congress designed §§ 22(d) and 22(f) [of the Investment Company Act] to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market" (App. A, *infra*, pp. 40–58). The court noted that prior to the passage of the Investment Company Act, a secondary market in open-end mutual fund shares had existed—the so-called "bootleg market." Sections 22(d) and 22(f),

[7]At the same time the court also dismissed complaints filed by private investors against most of the same defendants making similar allegations and seeking treble damages and injunctive relief. *Haddad* v. *Crosby Corp.*, Civ. No. 2454–72 (D.D.C.); *Gross* v. *National Ass'n of Secs. Dealers, Inc*, Civ. No. 426–73 (D.D.C.). Those dismissals have been appealed to the United States Court of Appeals for the District of Columbia Circuit.

the court said, were aimed at suppressing the "cut-price competition" in this market which had caused "discrimination between similarly situated investors" (App. A, *infra*, 48–50, 56–57).

Second, the district court held that the "pervasive" regulatory scheme of the Investment Company Act (15 U.S.C. 80a–1, *et seq.*) and the Maloney Act (15 U.S.C. 78*o*–3) was intended to replace the "usual anti-trust prohibitions in the narrow area of distribution and sale of mutual fund shares" (App. A, *infra*, pp. 56–57). In the court's view, Congress intended that supervision and control of this complex area should be committed exclusively to the regulatory authority of the Securities and Exchange Commission, under the Investment Company Act, and to the self-regulatory power of the NASD, subject to Commission supervision and review, under the Maloney Act.

THE QUESTIONS ARE SUBSTANTIAL

This appeal presents important questions involving the application of the antitrust laws to the multi-billion-dollar mutual fund industry, which has developed a distribution system that effectively prohibits any competition in the sale and redemption of its shares following the initial distribution of such shares to the public. The restraints alleged in the complaint ordinarily would constitute a *per se* violation of Section 1 of the Sherman Act. The basic question in this case is whether the regulatory scheme which Congress created for this industry was intended to exempt from the antitrust laws all transactions in mutual fund shares

subsequent to their initial distribtuion. We submit that it was not.

In Section 22(d) of the Investment Company Act, Congress provided a narrow exemption from the antitrust law: open-end mutual funds may engage in resale price maintenance by fixing the prices at which dealers sell their shares to the public while a primary distribution of such shares is under way. We submit, however, that neither in Section 22(d) nor in Section 22(f) did Congress permit horizontal price fixing. Funds may not set prices in a secondary brokerage market, and Congress did not sanction agreements among dealers through their trade association to eliminate competition in the sale and redemption of outstanding shares. If secondary brokerage and inter-dealer markets were given the opportunity to develop free of the restraints defendants have imposed, investors would have the alternative of price competition in both the purchase and the sale of mutual fund shares that had previously passed through the primary distribution chain.[8] Secondary markets exist for virtually all other transferable securities. If investors wish to take advantage of such markets, there is no reason why mutual fund shares should be an exception.

[8] The potential role of secondary markets is described in a recent report. See SEC Staff Study, *supra*, at A-111 to A-113, A-120 to A-121. A few dealers currently make markets in the most widely-held mutual fund shares. Other dealers with customers wishing to acquire or liquidate shares can go to these firms and avoid dealing with the fund itself and the principal underwriters. This market does not produce any monetary advantage to a "buying" investor, since all dealer sales to investors, under Section 22(d), must be made at the fixed public offering price so long as the same class of share is being offered to

In extending the limited antitrust immunity of Section 22, the district court departed from the well-established doctrines that exemptions to the antitrust laws must be narrowly construed and that an exemption from those laws for industry self-regulation may be implied only to the minimum extent necessary to make the regulatory system work. *United States* v. *Philadelphia Nat'l Bank,* 374 U.S. 321; *Silver* v. *New York Stock Exch.,* 373 U.S. 341; *United States* v. *McKesson & Robbins, Inc.,* 351 U.S. 305.

1. In ruling on the defendants' motions to dismiss the complaint prior to discovery or trial, the district court's function was "necessarily a limited one" of determining whether there were no facts the govern-

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the public by the fund or its underwriter. (Such a primary distribution of mutual fund shares is usually, but not always, continuous in nature. See SEC Staff Study, *supra,* at A-118.) It can, however, produce an advantage to "selling" investors because a dealer may be willing to pay more than net asset value for the shares. (The principal underwriter's 1.5 percent spread (see p. 6, *supra,* n. 5), which is avoided in the inter-dealer market, offers one opportunity for dealers to pay selling investors small increments above net asset value without cutting into their own commission income.) In addition, the inter-dealer market may permit selling investors to dispose of their shares more quickly and easily than would be the case were the investor required to redeem them through the fund or its underwriter.

Another secondary market for the purchase and sale of open-end mutual fund shares would be a "brokerage market" in which investors could sell to one another using broker/dealer firms acting in the capacity of brokers as intermediaries. The buying and selling investors would be free to negotiate a price between the public offering price (which includes the sales load) and the net asset value (at which the fund is required to redeem) of the shares being transferred, thereby benefiting both parties to the transaction.

ment might prove under the broad allegations of the complaint that would entitle it to relief. *Scheuer* v. *Rhodes,* No. 72-914, decided April 17, 1974, slip op. 4; cf. *Poller* v. *Columbia Broadcasting Sys., Inc.,* 368 U.S. 464, 472-473.[9] Accordingly, the dismissal of the complaint can be sustained only if the Investment Company Act and the Maloney Act give the defendants antitrust immunity for all activities that the government might prove. Neither singly nor in combination, however, do those acts provide such sweeping immunity.[10]

2. The district court's conclusion that Section 22(d) of the Investment Company Act precludes all competition in the sale of shares of a mutual fund is contrary to the language of the Act, its legislative history, and

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[9] Although all the appellees moved to dismiss on the ground that the government's complaint failed to state a claim upon which relief can be granted, several appellees appended exhibits to their supporting memoranda and the government filed an affidavit describing certain attached documents in support of the allegations in its complaint. The district court, however, referred only to the allegations of the complaint. If the motions are treated as if for summary judgment, because of the introduction of matters outside the pleading (Fed. R. Civ. P. 12(b), (c)), the material allegations of the complaint must be taken as true, as with a motion to dismiss, and the inferences to be drawn from the underlying facts contained in the additionally submitted materials must be viewed in the light most favorable to the government. *Jenkins* v. *McKeithen,* 395 U.S. 411, 421; *United States* v. *Diebold, Inc.,* 369 U.S. 654, 655; *United States* v. *New Wrinkle, Inc.,* 342 U.S. 371, 376.

[10] Even if some of the actions of the appellees are immunized, the determination of the precise extent of such immunity may not readily be determined at the pleading stage "because of the absence of a factual record * * *." *Scheuer* v. *Rhodes, supra,* slip op. 17.

its longstanding interpretation by the agency responsible for its administration.

A. Section 22(d) establishes a limited system of vertical restraints: resale price-maintenance in the sale of open-end mutual fund shares by "dealers" to investors. Thus, Section 22(d) provides that if a class of redeemable security issued by an investment company is being currently offered to the public by or through an underwriter, "no principal underwriter of such security and *no dealer shall sell any such security* to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus * * *" (emphasis supplied).

By its terms Section 22(d) thus expressly excludes transactions between dealers from any price limitation, its requirements apply to sales of investment company securities by principal underwriters or dealers "to any person except a dealer * * *." Section 22 (d) therefore does not make lawful underwriter-dealer sales agreements designed to suppress a secondary inter-dealer market. The legal analogy is to state fair trade laws which do not validate agreements to set prices in second-hand markets.

Section 22(d) similarly does not cover the appellees' efforts to prohibit a secondary brokerage market. That section applies only to shares sold to the public by a fund, its principal underwriter or "dealers." It does not apply to transactions in outstanding shares that investors sell to other investors through a broker. Indeed, it does not even mention "broker."

As enacted in 1940, the Investment Company Act defined both "dealer" and "broker" separately.[11] Congress was quite precise in its use of both terms; they appear individually in various sections of the Act and, most importantly, together in a number of ways.[12] Thus, when Congress intended to include both brokers and dealers within a given provision, it used both terms. The use of "broker" in various sections of the Act and its omission from Section 22(d) reflects a deliberate intent to exclude brokerage transactions from the price-maintenance restrictions on sales to investors contained in that section. See, *e.g.*, *Federal Trade Commission* v. *Sun Oil Co.*, 371 U.S. 505, 514-515; *T.I.M.E. Inc.* v. *United States*, 359 U.S. 464, 470-471.[13]

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[11] See p. 5, *supra*, n. 4.

[12] "Broker" was used without any reference to a dealer in Sections 2(a)(6), 3(c)(2), 10(b)(1), 17(e)(1) and 17(e)(2). 15 U.S.C. 80a-2(a)(6), -3(c)(2), -10(b)(1), -17(e)(1) and (2). "Dealer" was used without reference to broker in Sections 2(a)(29), 2(a)(40), 22(c) and 22(d). 15 U.S.C. 80a-2(a)(29), -2(a)(40), -22(c), -22(d). Both "broker" and "dealer" were used together in Sections 1(b)(2), 2(a)(11), 9(a)(1), 9(a)(2), 12(d)(3), and 30(a). 15 U.S.C. 80a-1(b)(2), -2(a)(11), -9(a)(1) and (2), -12(d)(3), -30(a). See 54 Stat. 789, *et seq.*

When Congress amended the Act in 1970 (84 Stat. 1413), it continued to employ the terms "broker" and "dealer" together in Sections 2(a)(19)(A)(v), 2(a)(19)(B)(v), 12(d)(1)(B) and 12(d)(1)(E)(i). 15 U.S.C. 80a-2(a)(19)(A)(v) and (B)(v), -12(d)(1)(B) and (E)(i). In addition, it also used the general term "broker-dealer" in Sections 22(b)(1) and 22(b)(2). 15 U.S.C. 80a-22(b)(1) and (2).

[13] Section 22 is entitled "Distribution, Redemption, and Repurchase of Redeemable Securities," and all of its subsections concern transactions in or from the primary distribution chain of fund-underwriter-dealer-investor. There is nothing in the section, viewed as a whole, indicating an intent to regulate investor transactions executed through a broker.

In short, Section 22(d) permits a mutual fund to fix the price at which its shares may be sold to an investor by a person acting as a "dealer," but not the price at which two investors may transfer shares through a person acting as a "broker."

B. The district court's conclusion that the legislative history indicates that Section 22(d) was intended to suppress price competition in a secondary market for mutual fund shares rested largely on statements, studies and articles appearing decades after that Section was enacted (App. A, *infra*, pp. 50–55) and which are of slight value, if any, as evidence of congressional intention in 1940.[14] The few items in the actual history of the Act to which the court referred do not support its conclusion.

Noting one brief reference in the voluminous hearings and studies preceding the Act to the so-called "bootleg" secondary market in which price competition existed (App. A, *infra*, pp. 49–50), the district court concluded that Section 22(d) was intended to eliminate that market. There is, however, not one statement in the hearings, the committee reports, or the debates to support that conclusion. The reference

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[14] For example, the court relied upon characterization of the purpose and intended scope of Section 22(d) provided at Congressional hearings in 1967 in a different context which did not directly involve the question of its application to secondary markets. As a recent article demonstrates, statements of prior commentators about the history and purpose of Section 22 are not supported by close analysis of its history. See Heffernan & Jordan, *Section 22(d) of the Investment Company Act of 1940—Its Original Purpose and Present Function*, 1973 Duke L. J. 975.

to the "bootleg" market relied upon by the court consisted of one brief descriptive paragraph in a comprehensive SEC study of the investment company industry which totalled more than four thousand pages.[15] The SEC did not indicate that this market was a problem requiring congressional regulation, and the original bill[16] contained no provision comparable to the portions of Section 22(d) here involved. In the hearings there was no reference to the "bootleg" market in the discussion of Section 22(d) and its purposes.[17]

Section 22(d), as enacted, first appeared in a superseding bill reflecting a negotiated compromise between the SEC and the mutual fund industry. The elimination of the secondary market was not included in a list of the differences between the original and new bills (Senate Hearings, pt. 2, at 1118), and neither the Senate nor the House report referred to the "bootleg" market.[18] Indeed, the House Report described

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[15] SEC, *Report on the Study of Investment Trusts and Investment Companies*, H. Doc. No. 707, 75th Cong., 3d Sess.; H. Doc. No. 70, 76th Cong., 1st Sess.; H. Doc. No. 279, 76th Cong., 1st Sess., pts. 1–3; H. Doc. No. 136, 77th Cong., 1st Sess.; H. Doc. No. 246, 77th Cong., 1st Sess. The last two volumes of the report were not submitted to Congress until after the Act had been passed.

[16] S. 3580, 76th Cong., 3d Sess. The bill is set forth in the Hearings before a Subcommittee of the Senate Committee on Banking and Currency on Investment Trusts and Investment Companies, 76th Cong., 3d Sess., pt. 1, at 1–32 ("Senate Hearings").

[17] The "bootleg" market was referred to in the hearings in connection with Section 22(f), as is noted below. See p. 22, *infra.*

[18] See S. Rep. No. 1775, 76th Cong., 3d Sess. 16; H. Rep. No. 2639, 76th Cong., 3d Sess. 20. Nor was there any pertinent reference to Section 22(d) in the debates. See 86 Cong. Rec. 9807–9819, 10069–10071.

Section 22(d) as prohibiting only "investment companies from selling their redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." H. Rep. No. 2639, *supra,* at 20.

As the House Report indicates, the overriding purpose of Section 22(d) was to prohibit sales of mutual fund shares to some persons, in the course of a primary distribution of such shares, at prices lower than those paid by the investing public. The legislative history of Section 22 reveals that, in addition to excessive sales loads, one of the principal evils which concerned Congress was the discriminatory sale of mutual fund shares, in their primary distribution, to insiders at prices below the price to the public, thereby permitting riskless trading by insiders and dilution of the value of shares held by investors.[20]

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[19] The Senate Report similarly stated that the purpose of Section 22(d) was "to prohibit the sale of redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public." S. Rep. No. 1775, *supra*, at 16. This statement, like that of the industry witness quoted by the court (App. A, *infra*, p. 38), does not purport to apply to sales in a secondary market, but rather was aimed at sales during a primary distribution of shares, to which the original SEC bill explicitly referred. Senate Hearings, pt. 1, at 15.

[20] See, *e.g.*, SEC, *Investment Trusts and Investment Companies*, pt. 2, H. Doc. No. 279, 76th Cong., 1st Sess. 809–820, 847–874; Hearings before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 10065, Investment Trusts and Investment Companies, 76th Cong., 3d Sess., at 58–59, 78, 80–81; Senate Hearings pt. 1, at 136–145, 187–188, 288–291; *id.*, pt. 2, at 332–336, 485, 514–527, 612, 660–663, 799–801, 836–863, 940–941, 949, 1053, 1057; *id.*, pt. 3, at 1085–1096; *id.*, pt. 4, at 1118; H. Rep. No. 2639, *supra*, at 8, 20; S. Rep. No. 1775, *supra*, at 6, 7, 16.

The existence of secondary markets in which price competition occurred would not weaken the congressional efforts to eliminate these problems. Contrary to the district court's conclusion, it would not result in "price discrimination between similarly situated investors" (App. A, *infra,* p. 47), because all investors would be equally free to avail themselves of the secondary market. With respect to the problem of excessive sales loads, the existence of a secondary market in which there is price competition might induce the mutual funds themselves to lower their sales loads.

C. The Commission has explicitly and repeatedly interpreted the Act from the outset as permitting competitively-priced transactions in secondary markets for mutual fund shares, notwithstanding Section 22.[21] Although such a contemporaneous construction by an agency responsible for administering a statute it helped to draft is entitled to the greatest weight

[21] Thus, by letter dated March 14, 1941, in response to a request by appellee NASD, the SEC's general counsel rendered a formal opinion that a broker-dealer would not be required by Section 22(d) to observe the current offering price in a sale to an investor when acting as a broker, although he would if acting as a dealer. The opinion was published by the SEC (11 Fed. Reg. 10992) and is still listed as an authoritative "interpretative release" in the current SEC regulations. 17 C.F.R. 271.

One month later the full Commission noted—with no suggestion that it was barred by Section 22(d)—the existence of a "secondary market" in mutual fund shares, operating "in the range between the public offering price and the redemption price * * *," which "closely resembles the traditional over-the-counter market in other securities * * *." *Proposed Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc.*, 9 S.E.C. 38, 46, n. 12.

The Commission itself adopted the general counsel's 1941 analysis in 1946 (*Oxford Co.*, 21 S.E.C. 681), where it stated

(*Zuber* v. *Allen,* 396 U.S. 168, 192), the district court erroneously disregarded these interpretations as being merely *"ad hoc* decisions" (App. A, *infra,* p. 67, n.61). But that characterization—and many settled administrative interpretations upon which this Court has relied could be similarly characterized—cannot obscure the fact that for more than 30 years the agency has followed this interpretation.[22]

that the requirement that sales be made at public offering price "does not apply to broker transactions, as we have long ago advised the trade." *Id.* at 690.

More recently, in 1972, when a broker-dealer requested exemption from Sections 17(a)(1) and 22(d) of the Act to permit it to buy other funds' shares for its affiliated mutual fund holding company from the principal underwriters of such other funds at dealer cost rather than the public offering price, the SEC denied the request because the broker-dealer would be acting as a broker, not a dealer, and would therefore not be subject to Section 22(d). *Mutual Funds Advisory, Inc.*, Investment Co. Act Rel. No. 6932, Jan. 12, 1972.

The industry, too, apparently understood at the outset that Section 22(d) did not require that inter-dealer and brokerage transactions be at the public offering price. See, *e.g.*, Motley, *Federal Regulation of Investment Companies Since 1940*, 63 Harv. L. Rev. 1134, 1145 (1950); NASD *Manual* ¶ 5269. Indeed, the NASD acknowledged in the district court that Section 22(d) does not appear to bar all secondary market transactions at other than the public offering price—including particularly inter-dealer sales and sales by an investor to another investor through a broker (NASD Memorandum in Support of Motion to Dismiss, p. 13).

[22] As noted above (see p. 16, *supra*, n. 14), the court relied heavily on statements made by SEC representatives in 1967 in support of their efforts to have Section 22(d) repealed (App. A, *infra*, pp. 51–54). Despite the breadth of some of the language, the statements were directed at resale price maintenance in the primary distribution of mutual fund shares and did not purport to apply to the secondary markets, which, because of the restraints alleged in the complaint, have not been permitted to develop.

3. The district court further erred, we submit, in holding that Section 22(f) of the Investment Company Act immunized appellees' practices from the antitrust laws. Neither the language, purpose, or legislative history of that section supports the ruling.

Although the restrictive practices specified in the complaint involved underwriting agreements and dealer sales agreements, the court concluded that they were immunized from antitrust challenge by Section 22(f), which provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

The restraints alleged in the complaint, however, do not in terms involve restrictions imposed by mutual funds on the transferability or negotiability of their shares, and it cannot be concluded on the basis of the complaint alone that all of the restraints that the government might prove would be covered by Section 22(f), whatever its effects might be.

In any event, the district court erred in concluding that Section 22(f) was "a necessary companion" to Section 22(d), intended to implement the statutory suppression of competitive secondary markets (App. A, *infra,* p. 56). Unlike Section 22(d), Section 22(f) had a forerunner in the original SEC bill, which

would have authorized the SEC to prohibit restrictions on transferability or negotiability of mutual fund shares, Senate Hearings, pt. 1, at 16. A Commission official testified that some investment companies had included such restrictions in their certificates as a means of combatting what "they call the bootleg market," and that such restrictions take away "a big portion of the owner's right of initiative," the authority was sought to regulate such restrictions, if necessary. Senate Hearings, pt. 1, at 292–293. Such authority was provided in Section 22(f).

The legislative history, however, contains no indication that Section 22(f) itself, without any implementing Commission regulations,[23] was intended to eliminate a competitive secondary market.[24] Rather, it was intended to authorize the SEC to impose requirements which must be satisfied if restrictions on transferability or negotiability were to be valid under the Act. See S. Rep. No. 1775, *supra,* p. 16; H. Rep. No. 2639, *supra,* p. 20.[25]

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[23] The Commission has not adopted any regulations pursuant to Section 22(f).

[24] An industry counterproposal offered as a substitute for the SEC bill contained no provision for restrictions on transferability. Senate Hearings, pt. 2, at 1057. If Section 22(f) was really intended to assist, rather than restrict, the industry in its efforts to eliminate a secondary market, it is unlikely that the industry's bill would not have explicitly so indicated.

[25] Requirements imposed by the Commission would be in addition to such limitations under other federal and state laws as might be applicable to efforts to restrict the transferability or negotiability of the shares of a mutual fund. For example, the laws of Massachusetts and Maryland, where several of

Finally, even if Section 22(f) could be read as authorizing a mutual fund to impose vertical restrictive provisions upon a principal underwriter and through it upon dealers handling its shares, it would not immunize the collusive action to secure such restrictions alleged in Count I of the complaint. This Court has held that, where unilateral conduct is sanctioned by a regulatory statute, agreement among competitors to engage in that conduct may nevertheless be an antitrust violation. *Georgia* v. *Pennsylvania R.R.*, 324 U.S. 439, 456–459. As noted (*supra*, pp. 7–8), the government's complaint in this case charged such collective action by the appellees

4. Alternatively, the district court held that the appellees' practices have an "implied immunity" from the antitrust laws that results from the "pervasive" regulatory scheme of the Investment Company and the Maloney Acts (App. A, *infra*, p. 59). That conclusion, however, is erroneous.

A. Regulatory legislation does not ordinarily result in "implied" antitrust immunity for the activities of those who are subject to regulation. "Repeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *United States* v. *Philadelphia*

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the appellee funds are incorporated, require that restrictions on transferability of a share appear on the face of the share certificate. Mass. Laws Ann., C. 156B, sec. 27; Md. Code Ann. Art. 23, sec. 27(c). See also 8 Del. Code, sec. 194.

Nat'l Bank, supra, 374 U.S. at 350–351.[26] This Court has repeatedly rejected claims of broad implied antitrust immunity in cases involving extensively regulated industries. See *Philadelphia Nat'l Bank, supra* (banks); *Silver* v. *New York Stock Exch., supra* (securities exchanges); *California* v. *Federal Power Commission,* 369 U.S. 482 (natural gas producers); *Otter Tail Power Co.* v. *United States,* 410 U.S. 366 (electric utilities); and *United States* v. *Radio Corp. of Am.,* 358 U.S. 334 (broadcasters).

Such antitrust immunity has been found only where the statutory scheme defines and specifies an exclusive regulatory responsibility to deal comprehensively with questions of competition. See *Pan American World Airways, Inc.* v. *United States,* 371 U.S. 296; *Hughes Tool Co.* v. *Trans World Airlines, Inc.,* 409 U.S. 363. Under these decisions, for immunity to exist (1) the conduct challenged in the antitrust litigation must constitute the "precise ingredients" of a case subject to the agency's regulatory and remedial responsibilities (*Pan American, supra,* 371 U.S. at 305); (2) the statutory scheme must require the agency to focus particularly on competitive considerations in exercising those powers (*id.* at 308–309); and (3) the agency must have express authority under the statutory scheme to immunize the conduct in question

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[26] Moreover, "since resale price maintenance is a privilege restrictive of a free economy * * *," statutes authorizing such restrictions are to be construed "strictly." *United States* v. *McKesson & Robbins, Inc., supra* 351 U.S. at 315–316.

from the antitrust laws (*id.* at 309).[27] See *Hughes Tool, supra,* 409 U.S. at 384–389.

These criteria are not met here and the district court did not even attempt to apply them. It merely stated generally that the "pervasive" regulatory scheme of the Investment Company and the Maloney Acts immunizes the defendants' activities here challenged (App. A, *infra,* p. 59). The Commission's regulatory authority, however, is carefully defined as to subject matter, scope of power, and standards to be applied.[28]

B. Similarly erroneous is the district court's interpretation of *Silver* v. *New York Stock Exchange, supra. Silver* involved the application of the antitrust laws to the New York Stock Exchange, in the exercise of its self-regulatory function by terminating direct wire connections between member and non-member firms. The SEC had no authority to review the Exchange's action. This Court held that antitrust im-

[27] These factors are reflected in this Court's opinion in *Philadelphia Nat'l Bank, supra,* 374 U.S. at 351, where *Pan American* is distinguished. Accord, *Ricci* v. *Chicago Mercantile Exch.*, 409 U.S. 289, 302–303, n.13.

[28] Thus, while Section 22(f) gives the Commission certain rule-making authority (which it has not exercised) with respect to restrictions on transferability of shares imposed by a mutual fund, as explained *supra,* p. 23, this section gives no authority over the horizontal combination of the NASD and its members charged in Count I of the complaint or the dealer-underwriter sales agreements challenged in the remaining counts. In any case, the section does not require the Commission to examine competitive considerations or empower it to grant antitrust immunity. Cf. *City of Lafayette* v. *Securities & Exchange Commission*, 454 F.2d 941 (C.A.D.C.).

munity would be implied only if the particular acts of self-regulation fell within the scope and purposes of the Securities Exchange Act, and then only to the minimum extent necessary to make the regulatory act work. *Id.* at 357. Had the Exchange's actions been subject to SEC review, the Court said, then "a different case" as to antitrust exemption would be presented. *Id.* at 358, n. 12.[29]

The district court stated that the present antitrust suit is that "different case" (App. A, *infra,* p. 62). Since NASD rules are subject to SEC review, the court reasoned, application of the antitrust laws would be neither necessary nor appropriate. This is especially so, the court concluded, since the Maloney Act (which requires the NASD to register with the SEC) requires the SEC to employ antitrust standards in reviewing NASD rules (15 U.S.C. 78*o*-3(b)(8)) and expressly confers immunity from conflicting statutes. 15 U.S.C. 78*o*-3(n).

The court's reasoning, however, ignores the horizontal conspiracy alleged by the government. The complaint challenges no rule or regulation of the NASD or the SEC. None of the NASD rules, on its face, requires or necessarily results in suppression of the secondary brokerage or inter-dealer markets.[30]

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[29] The majority opinion specifically referred to the SEC's review of NASD disciplinary action and the express antitrust exemption under the Maloney Act, but declined to decide how such a case should be treated. *Ibid.*

[30] Indeed, when the Commission approved Rule 26 of the NASD Rules of Fair Practice, governing the distribution of mutual fund shares, it expressly recognized that the rule would not affect transactions in the secondary market. *Proposed*

Rather, this case involves a broad and continuing course of conduct on the part of the NASD and its members, including purported NASD interpretations of its rules communicated to its members but not submitted to or reviewed by the Commission.[31]

This case thus closely parallels *Silver*. The NASD activities challenged in the complaint that have never been reviewed or approved by the SEC are immune from antitrust attack only if they are (1) clearly within the scope and purposes of the Investment Company or Maloney Acts, and (2) necessary to make those acts work. The former act was designed to eliminate such problems as excessive sales loads and the

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Amendment to the Rules of Fair Practice of Nat'l Ass'n of Secs. Dealers, Inc., supra, at 9 S.E.C. 38, 44, 46, n. 12.

[31] Documents attached to the government's opposition to the motions to dismiss indicate that the NASD approached the Commissions staff in 1959 and broached the idea of an interpretation of NASD Rule 26 which would have prevented NASD members from participating in the secondary inter-dealer market. The staff advised the NASD that neither the Investment Company Act nor its legislative history would support such a rule and that it would oppose this interpretation if the NASD formally proposed it to the Commission. The NASD thereupon stated that it would abandon the proposal, but, without prior notice to the Commission, sent a letter to all principal underwriter members urging them to include in their sales agreements with dealers, and to enforce, contractual provisions restricting inter-dealer transactions. Such immunity as might exist if the NASD had followed the procedures prescribed by the Maloney Act for obtaining Commission review of its actions would, of course, be unavailable if the NASD had ignored procedures ~~prescribed in the Act for obtaining~~ and had failed to obtain such Commission review. *United States* v. *Borden Co.*, 308 U.S. 188, 197–202; *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 225–227.

operation of funds in the interest of underwriters and dealers rather than in the interest of investors (15 U.S.C. 80a-1(b)(2) and 15 U.S.C. 80a-22(b)), while the latter act expressly proscribes NASD rule-making that fixes prices and commissions. 15 U.S.C. 78o-3(b)(8). The appellees' activities, however, have resulted in the elimination of secondary brokerage and inter-dealer markets and in the fixing of prices and commissions on all mutual fund transactions, to the disadvantage of the investing public. Consequently, they are not entitled to immunity and constitute a combination in restraint of trade in violation of the Sherman Act.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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MAY 1974.

APPENDIX A

United States District Court
for the District of Columbia
(Civil Action No. 2454–72)
GENEVIEVE M. HADDAD

v.

THE CROSBY CORP., ET. AL.
(Civil Action No. 338–73)
UNITED STATES OF AMERICA

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, ET AL.
(Civil Action No. 426–73)
ARTHUR GROSS, ET AL.

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, ET AL.
FILED DECEMBER 14, 1973.

JAMES F. DAVEY, *Clerk.*

MEMORANDUM OPINION

I

THE NATURE OF THE CASE

The above-captioned lawsuits are civil actions alleging violations of the federal antitrust laws in connection with the distribution of securities of open-end management investment companies ("mutual funds").[1]

[1] By definition an open-end management investment company is any issuer which (1) "is or holds itself out as being primarily . . . in the business of investing, reinvesting, or trading in securities" (15 U.S.C. § 80a–3); (2) is not a face-amount

The operations of such companies are governed generally by the Investment Company Act of 1940 [2] (the 1940 Act).

In Civil Action No. 2454–72, plaintiff Haddad purports to sue on behalf of a class and subclass of mutual fund investors. Haddad alleges violations of the antitrust laws [Sherman Act, Sections 1–3, 15 U.S.C. §§ 1–3)] and the securities laws [Securities Exchange Act of 1934, Section 10(b), 15 U.S.C. § 78j(b); Exchange Act Rule 10b–5, 17 C.F.R. § 240.10b–5 (1972)]. The antitrust claim is that the various defendants, including underwriters of and dealers in mutual fund shares and unnamed co-conspirators have agreed, combined and conspired to inhibit, or to refuse to participate in, transactions as agents or brokers in mutual fund shares at prices below the applicable public offering prices established in the prospectuses of such mutual funds and have placed unreasonable restraints upon the transferability of such shares. In essence, the securities claim is that there is a failure to disclose the alleged antitrust violations and that such failure constitutes an independent violation of the securities laws. Haddad alleges damages to her and her purported class of undetermined millions of dollars. Haddad's antitrust claim requests treble damages and injunctive relief. The securities claim requests actual damages, punitive damages, and injunctive relief.

Civil Action No. 338–73 is brought by the Antitrust Division of the U.S. Department of Justice. The complaint alleges violations of Section 1 of the Sherman Act, 15 U.S.C. § 1. The gist of the complaint is that

certificate company or a unit investment trust (15 U.S.C. § 80a–4); and (3) is "offering for sale or has outstanding any redeemable security of which it is the issuer" (15 U.S.C. § 80a–5).

[2] 15 U.S.C. § 80a–1, *et seq.* (1970).

defendants National Association of Securities Dealers (NASD),[3] funds and dealers have participated in agreements, combinations, and conspiracies, the effect of which has been to inhibit a "market" for "brokerage transactions" and thereby to suppress the growth of a "secondary market in mutual fund securities," and to cause the public to pay artificial and non-competitive sales loads for mutual fund shares. The government complaint seeks only prospective injunctive relief.

Civil Action No. 426–73, the Gross case, is another private antitrust suit and purported class action which substantially duplicates the government allegations in No. 338–73. This action seeks injunctive relief and treble damages for injury to the purported plaintiff class over an indeterminate past period.[4]

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[3] The NASD, incorporated in Delaware on July 18, 1939, became registered under the Maloney Act, § 15A of the Securities Exchange Act of 1934, 15 U.S.C. § 78o–3, on August 7, 1939. National Association of Securities Dealers, Inc., 5 S.E.C. 627 (1939). It is the only association ever to have applied for or been granted registration under the Maloney Act. Its membership is comprised of some 4400 broker-dealers and principal underwriters.

[4] Since the filing of the above-captioned actions, some fifty private suits, purporting to be class actions under *Fed. R. Civ. P.* 23, have been filed in various United States District Courts around the country. These cases have been transferred to this district by the Judicial Panel on Multidistrict Litigation, and are collectively cited as: In Re Mutual Fund Sales Antitrust Litigation, Civil Action No. Misc. 103–73. Pre-trial discovery and other activity in all cases (including the instant cases) has been stayed pending disposition of the motions to dismiss under consideration here.

The Court has also reserved judgment in all alleged class suits on the question of whether the actions may be maintained as class actions under *Fed R. Civ. P.* 23.

The individual defendants in each case are principal underwriters[5] or broker-dealers[6] in mutual fund shares.[7] Additionally the NASD is named as a defendant in all three cases. In each case the defendants have moved to dismiss the complaints, pursuant to *Fed. R. Civ. P.* 12(b) on the grounds:

(a) That as a matter of law, Section 22(d) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(d), establishes a system of fixed, retail price maintenance in the distribution of investment company securities which is totally inconsistent with antitrust concepts and which accordingly creates, as Congress clearly intended, an exemption and immunity from

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[5] A principal underwriter is defined by the 1940 Act as any underwriter who as principal purchases from (an open-end investment) company, or pursuant to contract has the right . . . from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company. 15 U.S.C. § 80a-2(a)(29).

[6] A broker is defined by the 1940 Act as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies." 15 U.S.C. § 80a-2(a)(6). A dealer is defined as "any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." 15 U.S.C. § 80a-2(a)(11).

[7] The identities of all the parties in each of the above-captioned cases are reflected in the accompanying Orders.

antitrust liability for the defendant dealers' conduct in maintaining the fixed, public offering price of such securities;

(b) That as a matter of law, Section 22(f) of the Investment Company Act of 1940, 15 U.S.C. § 80a-22(f), sanctions contractual restrictions on the transferability or negotiability of investment company securities, subject to supervision of the Securities and Exchange Commisson (SEC), whch restrictions are totally inconsistent with antitrust concepts and which restrictions, therefore, as incorporated in the defendant dealers' publicly-filed investment company sales agreements, are exempt and immune from antitrust liability; and

(c) That by the Investment Company Act of 1940, Congress subjected the acts and practices of the defendant dealers in the distribution of investment company securities to continuous and pervasive regulation by the SEC as well as NASD acting under the SEC's supervision; and, accordingly, the SEC has exclusive jurisdiction to regulate those acts and practices, and such acts and practices are exempt and immune from the claims herein alleged as violations of the Federal antitrust laws.

The motions were consolidated for argument.[8]

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[8] In opposition to the motions to dismiss all the plaintiffs also rely on the proposition that a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that plaintiffs are unable to prove any set of facts which would entitle them to relief. Neither the defendants nor this Court have any argument with that general proposition, but, as the issues are drawn here for purposes of these motions to dismiss, they are strictly legal ones as to which the facts as alleged in the complaints or otherwise are not relevant.

II

THE REGULATION OF MUTUAL FUNDS

The dispute can only be determined ultimately by an analysis of the several subsections of Section 22 of the 1940 Act and an antitrust exemption purportedly given by Section 15A(n) of the Securities and Exchange Act of 1934 (the Maloney Act) [15 U.S.C. 78*o*–3(n)]. Before reaching that point, however, it would seem appropriate to view the overall regulatory scheme imposed by Congress on investment companies through the 1940 Act.

It became apparent to the Congress in 1935 that the disclosure and antifraud provisions of the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) were not adequate for the regulation of investment companies. Accordingly, it directed the SEC to make a comprehensive study of the investment company industry with a view to proposing corrective legislation.

The SEC did so[9] producing a draft "Investment Trust Bill" which was the subject of hearings conducted by a Senate subcommittee.[10] Representatives of the investment company industry were invited to participate in the hearings. Ultimately a compromise bill emerged which finally became law as the Investment Company Act of 1940, 15 U.S.C. § 80a–1 *et seq.*[11]

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[9] *Report of the SEC, Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies, H.R. Dock. No.* 279, 76th Cong., 1st Sess. (1939) (hereinafter cited as *Investment Trust Study of 1940*).

[10] *Hearings on S. 3580 Before a Subcomm. of Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. (1940) (hereinafter cited as *1940 Senate Hearings*).

[11] That Act included § 22(d), one of the sections in controversy in this case, discussed *infra*. Section 22(d) prohibited sales

The 1940 Act brought many investment companies within the disclosure requirements of the federal securities laws for the first time. It tightened up those requirements and tailored them to prohibit certain undesirable practices in the investment company industry. Presently, pursuant to the 1940 Act investment companies must register themselves (§§ 7 and 8) and their shares [§ 24(a)] with the SEC, update periodically their filings with quarterly and annual reports [§§ 30(a)–(c)], and submit prospectuses and sales literature to the SEC [§ 24(b)]. Companies must issue to their shareholders, at least semi-annually, financial reports containing specific types of information [§ 30(d)].

The 1940 Act also imposes detailed restrictions upon investment company structure, conduct, financial policies, and dealings with and by affiliates.[12]

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of investment company shares to the public at any price other than the fixed public offering price.

[12] The Act delimits permissible methods for selecting directors of investment companies (and trustees in the case of investment trusts) (§ 16), sets out qualifications for securities custodians [§ 17(i)] and methods of safekeeping securities [§ 17(g)], and prohibits indemnification for official conduct [§§ 17 (h) and (i)]. Certain persons guilty of prior malfeasance are barred altogether from affiliating with investment companies, advisers, custodians, and principal underwriters (§ 9). Others who commit misconduct or abuse their positions of trust can be enjoined (§ 36). Misappropriation of company funds is made a federal crime (§ 37).

The Act also sets out minimum capitalization requirements for the companies (§§ 14 and 18). It requires a majority shareholder vote for changes in a company's open-end or closed-end nature, its diversification, its capacity to borrow money, issue senior securities, underwrite others' securities, purchase and sell real estate and commodities, or make loans, its investment policies, and its fundamental business (§ 13). Certain dividend distributions are barred unless timely disclosed to the shareholders (§ 19). Investment companies are barred from partici-

In 1938 (prior to the enactment of the 1940 Act), the Congress had amended the 1934 Act through the passage of the so-called "Maloney Act," 15 U.S.C. § 78o–3. The Maloney Act provided for the registration with the SEC of a national securities association with rule-making power upon the finding by the SEC that—

> the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market; and are not

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pating in certain types of securities transactions [§ 12(a)] and from making certain loans (§ 21). Some proxy solicitations are barred [§ 20(a)] and some exchanges need prior SEC approval (§ 11). Reorganization plans must be submitted to the SEC, which can render a negative advisory report and seek an injunction with respect to such reorganizations (§ 25). Voting trusts and cross or circular ownership patterns are barred (§ 35). Accountants must meet certain criteria, be selected in a particular fashion, and perform certain functions (§ 32). The regulated companies must keep and refrain from destroying certain books and records (§§ 31 and 34). Unit investment trusts (§ 26) and face amount certificate companies (§§ 28–29) are given special regulatory treatment.

The Act curtails the pyramiding of mutual funds [§§ 12(d)–(g)]. Unless it is itself the principal underwriter, no investment company may acquire shares of another company whose principal underwriter is related to the first company [§ 10(f)]. At least 40% of the company's board must consist of independent directors (§ 10). Advisory contracts must first be approved by a majority of directors unaffiliated with the adviser or by a majority of shareholders [§ 15 (c)]. Investment company transactions conducted by or with affiliated persons are prohibited in some cases and narrowly circumscribed in others (§ 17).

> designed to permit unfair discrimination between customers, or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.[13]

When Congress enacted the Maloney Act in 1938 it specifically provided:

> If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail. 15 U.S.C. § 78o–3 (n).

The defendant NASD is the only securities association registered with the SEC under the Maloney Act.

By § 22(a) of the 1940 Act, Congress gave the NASD, as a registered national securities association, the power to promulgate rules setting the minimum price at which its members may buy redeemable fund shares from a fund, the maximum price at which its members may resell to or redeem with a fund, and the minimum period which must elapse after sale before a member may resell to or redeem with a fund. The SEC can exercise its overall supervisory power to promulgate rules superseding NASD's rules on sale, redemption and repurchase prices, holding periods, and sales loads [§ 22(c) 1940 Act].

Section 22(b)(1) of the 1940 Act empowers the NASD to adopt rules prohibiting members from charging "excessive" sales loads, provided that such rules "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters."[14] In

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[13] § 15A(b)(8), 15 U.S.C. § 78o–3(b)(8).

[14] Before 1970, then-Section 22(b) authorized the NASD to issue rules barring "unconscionable" and "grossly excessive" sales loads, and then-Section 22(c) empowered the SEC to issue superseding rules for both NASD members and non-members.

so doing the NASD is expressly freed from a provision[15] in the Maloney Act which had prohibited it from issuing rules designed to impede "a free and open market," "fix minimum profits," "impose any schedule of prices," or "impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges." Section 22(b)(3) of the 1940 Act, added in 1970, authorizes the SEC to alter and supplement the NASD's Section 22(b)(1) rules.[16] And in 1970, Congress added Section 22(b)(4) to the 1940 Act to the effect:

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a–22(b)(4).

An investment company, its principal underwriter, and its dealers are prohibited from selling redeemable securities for distribution to the public except at a current public offering price described in the prospectus [§ 22(d)]. Dealers and principal underwriters may, however, sell such securities to other dealers, the principal underwriter or the fund at other than a public offering price. (*Id.*)

An investment company may restrict the transferability and negotiability of its shares, but only insofar as that is done in conformity with the company's

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[15] § 15A(b)(8), 15 U.S.C. § 78o–3(b)(8).

[16] The SEC may also grant qualified exemptions from NASD rules for "smaller companies" [§ 22(b)(1)]. Section 22(b)(2), another 1970 addition, gives the SEC the same rate-fixing powers over non-NASD broker-dealers as Section 22(b)(1) gives the NASD over its members. An underwriter whose shares are distributed by non-members of NASD, however, may elect to have its shares sold under the NASD rather than the SEC sales load rule. [§ 22(b)(2)].

registration statement and not in contravention of SEC rules [§ 22(f)].[17]

By rules and regulations upon its own motion and by order upon application, the Commission may conditionally or unconditionally exempt persons, securities, or transactions, or classes thereof, from any provision in the Act or any rule or regulation thereunder, to the extent such exemption is in the public interest and not inconsistent with investor protection and the Act's purposes [§ 6(c)].[18]

Finally, no person may be held liable for any act done in conformity with an SEC rule, regulation, or order which is later invalidated [§ 38(c)].

Since 1940, the SEC has actively regulated the pricing and distribution of mutual fund shares. The Com-

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[17] The 1940 Act contains other provisions with respect to distribution. Redemption privileges may not be suspended or postponed for more than seven days after tender except during certain exceptional circumstances as defined by the SEC [§ 22(e)]. A fund may not issue shares for services or property other than cash or securities except as a dividend or shareholder distribution or in a reorganization [§ 22(g)]. Thus watering of shares is prevented.

Investment companies issuing periodic payment plan certificates may charge no more than a 9% sales load, nor deduct more than 50% of that load from the first year's payments, nor deduct disproportionate amounts, nor allow periodic payments of less than certain small amounts, nor make proceeds subject to management or other fees which exceed the amount the Commission prescribes as reasonable (§ 27). 1970 amendments added refund requirements and empowered the SEC to make rules with respect to reserves. (*Id.*)

Close-end funds are specially regulated with respect to watering and repurchase prices (§ 23).

[18] Baum v. Investors Diversified Services, 286 F. Supp. 914, 921 (N.D. Ill. 1968), *aff'd*, 409 F. 2d 872 (7th Cir. 1969).

mission has promulgated a rule [19] for calculating fund share prices. It has promulgated another rule [20] allowing discount sales to certain groups and individuals and has periodically proposed [21] and adopted [22] amendments to this rule. It recently proposed a third rule [23] relating to no-load exchange privileges for fund shareholders who wish to switch to other load funds. The Commission has entertained a wide variety of applications for exemption from these rules and the relevant statutory sections and has granted some of these applications.[24] SEC administrative proceedings have barred both underpricing and overpricing of fund shares.[25]

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[19] Rule 22c–1, 17 C.F.R. § 270.22c–1, adopted in Investment Co. Act Release No. 5519 (1969), CCH *Fed. Sec. L. Rep.* '67–'69 Decisions ¶ 77,616.

[20] Rule 22d–1, 17 C.F.R. § 270.22d–1, adopted in Investment Co. Act Release No. 2798 (1958).

[21] Investment Co. Act Release No. 5507 (1968), in CCH *Fed. Sec. L. Rep.* '67–'69 Decisions ¶ 77,609; Investment Co. Act Release No. 6069 (1970) in CCH *Fed. Sec. L. Rep.* '69–'70 Decisions ¶ 77,826 and Investment Co. Act Release No. 7571 (1972) in CCH *Fed. Sec. L. Rep.* '72–'73 Decision ¶ 79,148.

[22] Investment Co. Act Release No. 6347 (1971), in CCH *Fed. Sec. L. Rep.* '70–'71 decisions ¶ 77,953.

[23] Rule 22d–2, proposed in Investment Co. Act Release No. 7555 (1972), CCH *Fed. Sec. L. Rep.* '72–'73 Decisions ¶ 79,132.

[24] See the list of more than 100 such applications in 4 CCH *Fed. Sec. L. Rep.* at p. 68,751 *et seq.* The Commission staff has issued an abundance of letters in response to "no action" requests with respect to these rules and the basic statutory provisions. From 1971 through March 21, 1973, there were 49 such letters listed in 4 CCH *Fed. Sec. L. Rep.* at pp. 63,134; 63,789; and 63,894.

[25] *See, e.g., Spiro Sideris*, Exchange Act Release No. 8816 (1970) (underpricing); *Russell L. Irish*, Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64–'66 Decisions ¶ 77,274 (overpricing). The Commission has also sought to regulate excessive "indirect" compensation to fund dealers. *E.g.*, SEC

The SEC has approved NASD Rule 26 which regulates in great detail the distribution, redemption, and repurchase of mutual fund shares.[26] The rule[27] says, *inter alia,* that principal underwriters must require their dealers to sign selling agreements containing certain restrictive provisions, that sales loads may not be "unfair," that the public offering price must be calculated in a particular fashion, that dealers and underwriters may not withhold customers orders or accumulative inventories, that certain conditional orders are barred, that the fund may not redeem at prices above net asset value, that sales loads must be refunded if the purchasers redeem soon after purchase, that fund shares may not be purchased at prices lower than the fund's next-quoted bid, and that non-contract dealers may not sell their shares back to the fund unless they are record owners of the shares. The SEC has supervised NASD enforcement of this rule and reviewed NASD enforcement proceedings.[28]

For more than three decades, since the enactment of the 1940 Act, the agreements between dealers and principal underwriters, and between principal underwriters and mutual funds, have been filed with the SEC. The agreements are filed under both the 1933 Act and the 1940 Act.[29] The Investment Trust Study of 1940 described such agreements in de-

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approval of new NASD Rules of Fair Practice, Section 26(k), which bars members from selling certain investment companies' shares in such a way that the companies will reciprocate with portfolio brokerage commissions, and conversely, Exchange Act Release No. 10147 (May 14, 1973), 5 *Fed. Sec. L. Rep.* ¶ 79,372.

[26] *Proposed Amendment to the Rules of Fair Practice of National Ass'n of Securities Dealers, Inc.*, 9 SEC 38 (1941).

[27] NASD Rules of Fair Practice, Article III, Section 26 in CCH NASD Manual ¶ 2176.

[28] *See* note 25 *supra.*

[29] *See* Part IV *infra.*

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tail.[30] The 1940 Act specifically calls for written contracts between funds and their principal underwriter [§ 15(b)]. As noted above, the Commission has approved a NASD rule which requires dealer-underwriter agreements; and Commission decisions have frequently turned on particular provisions of the dealer-underwriter agreements.[31]

III

THE OPERATION OF A MUTUAL FUND: RESALE PRICE MAINTENANCE

We look briefly at the manner in which a typical mutual fund operates within the foregoing framework.[32]

A mutual fund is an investment company which invests in the securities of other corporations and issues and has outstanding common stock representing an interest in the assets of the fund. The owner of the stock of the fund is entitled, on demand, to receive from the fund his proportionate share of the market value of the fund's net assets. To insure that the fund has sufficient cash or liquid assets on hand to meet current redemptions, the fund offers its common stock continuously. The offering price per share consists of

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[30] *See* note 47 *infra* and accompanying text.

[31] *See, e.g., Mutual Funds Advisory, Inc.*, Investment Co. Act Release No. 6932 (Jan. 12, 1972); *First Multifund of America, Inc.*, Investment Co. Act Release No. 6700 (1971), CCH *Fed. Sec. L. Rep.* '70–'71 Decisions ¶ 78,209 at p. 80,602; *Russell L. Irish*, Exchange Act Release No. 7687 (1965), CCH *Fed. Sec. L. Rep.* '64–'66 Decisions ¶ 77,274 at 82, 431 n. 13.

[32] *See generally Investment Trust Study of 1940; Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337*, 89th Cong., 2d Sess. (1966) (hereinafter cited as *Public Policy Report*).

the "net asset value" per share, computed daily, plus a sales charge or "load." The viability of a fund thus depends upon a distribution system which will effect continuous sales at prices which will support current redemption demands.

The primary distribution of the shares of a fund is controlled for the most part by § 22(d) of the 1940 Act and follows a basic pattern throughout the industry, *i.e.,* (1) a fund enters into a contract with a principal underwriter who has the exclusive right to purchase the shares from the funds; (2) the principal underwriter acts only as a wholesaler supplying shares to retail dealers; (3) the retail dealers, who sell the shares to the investing public, are bound by contracts, commonly known as uniform sales agreements, with the principal underwriter which require that those dealers shall not sell at other than the public offering price, thus insuring that the price of the fund shares will not be the subject of competition among sellers of shares in the same fund; (4) the sales charge or "load" (which usually amounts to 7.5% to 8.5% above net asset value) is split between the underwriter and the dealer making the sale while the fund receives the net asset value component of the public offering price; and (5) when the shares are redeemed by the fund, as they must be upon demand, the redemption price is the net asset value prevailing at the time of redemption.

It is obvious from the foregoing outline of marketing procedures that the sale and distribution of mutual fund shares is accomplished through a retail price maintenance system which is patently repugnant to the free and open competition requirements of the Sherman Act. This price maintenance scheme, however, does not operate in a vacuum. Rather, it is expressly immunized from the otherwise applicable anti-

trust laws by virtue of the provisions of the 1940 Act and the Maloney Act. As the SEC recently reported to Congress "Section 22(d) is an exception to the usual congressional policy, expressed in the antitrust laws, against price fixing.[33]

It has been authoritatively recognized that the Maloney Act, superimposed upon the regulatory scheme of the 1940 Act, provides a limited immunity for participants in the primary distribution system of mutual fund shares under SEC-approved NASD rules. That exemption[34] was noted by Mr. Justice Frankfurter in his dissenting opinion in ***International Association of Machinists* v. *Street*,** 367 U.S. 740, 809–10 n.16 (1961):

> The Maloney Act of 1938 added § 15A to the Securities Exchange Act of 1934. 52 Stat. 1070, 15 U.S.C. § 78o–3. In order to be registered, a number of statutory standards must be met. The statute specifically requires that an association's rules provide for democratic representation of the membership and that dues be equitably allocated. See § 15A(b) (5) and (6). Only one association, the National Association of Securities Dealers, Inc., has ever applied for or been granted registration. NASD membership comprises roughly three-quarters of all brokers and dealers registered with the Securities and Exchange Commission. Loss, Securities Regulation

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[33] *Public Policy Report* 218–19. *See Report of the Staff of the Securities and Exchange Commission on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* pt. I, at 1 (November 10, 1972) [hereinafter cited as *SEC Staff Report on Repeal of* §*22*(*d*)], CCH *Fed. Sec. L. Rep.* No. 450 (Nov. 15, 1972) pt. II, at A–1.

[34] *See also* the exemption from the antitrust laws provided by § 22(b)(4):

> If any provision of this subsection is in conflict with any provision of any law of the United States in effect on December 14, 1970, the provisions of this subsection shall prevail. 15 U.S.C. § 80a–22(b)(4).

766–67 (1951, Supp. 1955). Sections 15A (i) and (n) of the Act authorize the NASD to formulate rules which stipulate that members shall refuse to deal with nonmembers with immunity from the antitrust laws. See S. Rep. No. 1455, 75th Cong., 3d Sess. 8–9 (1938); Loss, *op. cit., supra,* 769–770. The Commission has stated that it is "virtually impossible for a dealer who is not a member of the NASD to participate in a distribution of important size." *National Association of Securities Dealers, Inc.,* 19 S.E.C. 424, 441.

Again, in *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150, 227 n.60 (1940), Mr. Justice Douglas stated:

> It should be noted in this connection that the typical method adopted by Congress when it has lifted the ban of the Sherman Act is the scrutiny and approval of designated public representatives. Under the N.I.R.A. this could be done through the code machinery with the approval of the President as provided in §§ 3(a) and 5, *supra* note 18. Under § 407(8) of the Transportation Act of 1920, [41 Stat. 482; 49 U.S.C. § 5(8)], carriers, including certain express companies, which were consolidated pursuant to any order of the Interstate Commerce Commission were relieved from the operation of the antitrust laws. *And see the Maloney Act (§ 15A of the Securities Exchange Act of 1934; 52 Stat. 1070) providing for the formation of associations of brokers and dealers with the approval of the Securities and Exchange Commission and establishing continuous supervision by the Commission over specified activities of such associations.* * * * (Emphasis added.)

The plaintiffs recognize a limited antitrust immunity accorded to the primary distribution system. The gravamen of their complaints, however, is that the defendants have conspired to use the primary distri-

bution system to foreclose the development of a secondary market in mutual fund shares. This is allegedly accomplished through the use of the uniform sales agreements mentioned above, which even after the primary distribution of the shares, set the price at which the shares shall thereafter be sold, thus precluding the dealers from selling shares as brokers in a brokerage market or as dealers in a secondary dealer market in which marketplace conditions and arms-length bargaining would be the price-setting factors. The plaintiffs insist that Congress, while allowing the primary market to flourish with benefit of antitrust immunity, did not intend to foreclose secondary market growth, but that such secondary markets are in fact being discouraged and suppressed by certain NASD rules and the restrictive provisions contained in the industry-wide uniform sales agreements between principal underwriters and dealers.

IV

SECTION 22, 1940 ACT

The fact that a secondary market is to all intents and purposes nonexistent might seem to substantiate the plaintiffs' claims. However, the position of the plaintiffs fails to take into account that the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act, and particularly by § 22(d), the repeal of which has several times been urgd upon Congress with no success. It is an economic fact, recognized by Congress, that the two markets—the primary market described in Part III, *supra,* and a secondary market as urged by the plaintiffs—cannot co-exist and both remain viable. Having established a resale price maintenance system in the primary distribution system in

which ordinary competitive influences cannot operate, Congress has rejected all attempts to foster a secondary market which might operate to the detriment of the primary market.

In support of those conclusions we look to the legislative history of the key sections of the 1940 Act and to the congressional intent in enacting that legislation.

A. SECTION 22(d)

Section 22(d) provides in pertinent part,

> * * * no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus.

As written, and as applied, that language clearly contemplates a congressionally sanctioned retail price maintenance system which is inconsistent and in conflict with the antitrust laws so far as underwriters and dealers are concerned.

Plaintiffs assert, however, that since the term "broker" or "broker-dealer" is not used in the subsection, that 22(d) permits a person to sell to another through a broker at a price less than the specified public offering price for the same shares, and that the absence of a significant brokerage market in those shares implies the existence of conspiratorial anticompetitive activity on the part of defendants to prevent the growth of that market.

This argument, however, ignores the price maintenance purpose of § 22(d) and its corollary that there must not be price discrimination between similarly situated investors.

On this latter point, so far as this Court is aware, there is no SEC or SEC staff pronouncement which can be construed to sanction price discrimination be-

tween similarly situated investors. To the contrary the SEC has said:

> The purposes of the Section [22(d)] are to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus. Investment Company Release No. 2798 (December 2, 1958). *See also* Investment Company Release Nos. 8816 (February 13, 1970); 2718 (May 29, 1958); (March 13, 1940). *See In the Matter of Investors Diversified Service,* 39 SEC 680 (1960).

Again, in its most recent annual report the SEC has stated:

> Section 22(d) precludes the sale to public investors of redeemable investment company securities which are being currently offered to the public on or through an underwriter except at a current public offering price described in the prospectus. SEC, *Thirty-eighth Annual Report* 97.

Thus, the language of the statute, its legislative history and subsequent interpretation by the SEC all indicate that its object was to allow the pre-1940 method of mutual fund share distribution to continue subject to the changes necessary to suppress what was sometimes dubbed the "bootleg" market. Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940,* 37 *U. Det. L.J.* 369, 371 (1960); *In the Matter of Spiro Sideris,* Securities Exchange Act Release No. 8816 (Feb. 13, 1970).

The legislative history of § 22 indicates that in the pre-1940 period there was in fact a secondary market in mutual fund shares, a market very similar in size and scope as that for which plaintiffs here attempt

to make a case.[35] This market—the "bootleg market"—was being maintained by brokers and dealers who were not under contract with the issuers or underwriters and who were not, accordingly, a part of the established distribution system of any given fund.

Those non-contract broker-dealers, without the authority of fund underwriters and in competition with authorized retail distributors of mutual fund shares, were buying shares in the market directly from shareholders at a price slightly above the published redemption price and reselling them to investors at prices lower than those fixed by the funds' principal underwriters.[36] Contract dealers operating in the primary

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[35] *Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. (1940); *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. (1940); *S. Rep. No.* 1775, 76th Cong., 3d Sess. (1940); *H.R. Rep. No.* 2639, 76th Cong., 3d Sess. (1940); *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967); *Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. (1967); *S. Rep. No.* 1351, 90th Cong., 2d. Sess. (1968); *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. (1969); *S. Rep. No.* 184, 91st Cong., 2d Sess. (1969); *H.R. Rep. No.* 1382, 91st Cong., 2d Sess. (1970); *H.R. Rep. No.* 1631, 91st Cong., 2d Sess. (1970).

[36] *Investment Trust Study of 1940* 865; *see also Hearings on H.R. 9510 and 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess. 59 (1967) (hereinafter cited as *1967 House Hearings*).

distrisystem, on the other hand, were obligated by their distribution contracts to sell fund shares at the price (including the sales charge) set by the principal underwriters.

Thus, non-contract dealers were effectively by-passing the primary distribution system and retaining for themselves the selling commissions in full.[37] If investors bought in the secondary market but redeemed through the fund, it was feared that redemptions would exceed sales of new shares and the fund would no longer have the cash available to satisfy its redemption obligations. Thus if the proceeds of new sales did not accrue to the fund, forced liquidation might result.

The congressional response to the problems of the pre-1940 market conditions was § 22. By § 22(f), *infra*, a fund was given the right to limit transferability. By § 22(d), all dealers were required to maintain the public offering price in sales to the public. The effect of the Act was for the first time to bind non-contract dealers to the public offering price. A stated purpose of § 22(d) was to insure that "no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors." [38]

This was a clear recognition that cut-price competition resulted in discrimination between similarly situated investors.

"Another factor in the decision to give statutory sanction to price fixing in 1940 was the fact that mutual fund distribution was then and for many years thereafter conceived of as a specialized type of under-

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[37] *Investment Trust Study of 1940* 864; *Public Policy Report* 219.

[38] *1940 Senate Hearings* 1057.

writing, and underwriting was regarded as a field in which the law sanctioned price fixing." *1967 Senate Hearings* 153–54 (Chairman Cohen). *Cf. United States* v. *Morgan,* 118 F. Supp. 621, 697 (S.D.N.Y. 1953).

As alluded to *supra,* a very real danger of the "bootleg" market was that its short term price advantage would drain profits from the primary distribution system and leave the issuers unable to engage in continuous sales of new securities necessary for long-term growth and the financial health of a fund. According to one commentator, a purpose of the price maintenance provisions was "to prevent the cut-price competition which had then been making serious inroads upon the contractual distribution system of the mutual fund underwriting firms." Greene, *Uniform Offering Price, supra,* 37 *U. Det. L. J.* at 371.

Section 22(d) has been reconsidered by Congress several times. Its modification or repeal has been urged. Congress has consistently refused to modify or repeal it, and in the course of hearings on various proposals, the position of the SEC and the congressional intent are clearly reflected. For example, in 1967 Congress was re-examining the problems of public offering prices and sales loads. It was being urged that competition for sales loads could only be realized by a repeal of 22(d). While testifying before the Senate Committee, then-Chairman of the SEC Cohen remarked:

> However, this argument [that 22(d) be repealed to allow competition] overlooks a fundamental theme of state and federal securities regulation. Securities regulation has done a good deal for the knowledgable investors, principally by increasing the quantity and improving the quality of the information available to them. But one of its primary concerns has always been the welfare of the unsophisticated

> investor, who is often the one most likely but least able to bear the burden of high charges in a competitive market. If it is desirable for millions of unsophisticated investors of modest means to invest in securities through the medium of mutual funds, it is also desirable that they should not subsequently have cause to believe that they were unfairly dealt with.
>
> On balance, we concluded therefore that a modification of the manner in which sales charges on mutual fund shares are now regulated was more consonant with the spirit and purpose of the securities laws than the elimination of Section 22(d). We therefore recommended that sales charges be limited to 5% of the amount invested, with authority in the Commission to raise this limit in appropriate situations.[39]

It is significant to note, that in the same hearings, some participants recognized that brokerage transactions, necessarily executed in the secondary market, were within the prohibition of § 22(d).

Senator Proxmire, for example, asked whether or not the SEC would recommend the repeal of 22(d) "in order to permit price competition in the sale of the same mutual fund by various broker-dealers."[40] Senator Mondale stated that section "22(d) permits—indeed makes it illegal for *agents* to sell at a sales charge less than that prescribed by the company,"[41] while Professor Paul Samuelson, Massachusetts Institute of Technology, testified that "Congress should repeal the provision in section 22(d) of the Investment Company Act of 1940 which prohibits a *broker* from selling mutual fund shares to the public at less than

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[39] *Hearings on S. 1659 Before the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 154–55 (1967) (hereinafter cited as *1967 Senate Hearings*).

[40] *Id.* 51–52.

[41] *Id.* 275 (emphasis added).

the public offering price."[42] Later in the hearings, Senator Mondale again remarked that "Section 22(d) makes it illegal for an *agent* to charge less than his company says he must charge as an *agent's fee,* but it does not prohibit or have anything to do with competition as between companies."[43]

Similar statements appear in the House Hearings, including the following exchange between Congressman Watkins and then-SEC Chairman Cohen:[44]

> Mr. Cohen. The statute now, and since 1940, interferes with competitive business in this area.
>
> Mr. Watkins. Not to the extent you are proposing.
>
> Mr. Cohen. I am sorry, sir. The statute is unequivocal. No person, no matter where he got it, from the issuer, from another dealer, or even from a private person, no broker-dealer may sell a share of a particular fund at a price less than that fixed by the issuer.
>
> Mr. Watkins. True.

In the same House Hearings, the Department of Justice, while urging the repeal of 22(d), characterized its provisions as follows:

> It is true that Congress, in originally enacting the "fixed price" provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws. In view of changed conditions, however, and the fact that the mutual funds are so important an outlet for the small investor, it would seem that he should not perhaps be deprived of the opportunity of purchasing his investment at a price arrived at

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[42] *Id.* 348 (emphasis added).

[43] *Id.* 769 (emphasis added).

[44] *1967 House Hearings* 711.

through the free operation of competitive forces.[45]

The SEC took the same view. The then-Chairman Cohen stated that "sellers of mutual fund securities have been insulated by Federal Law from price competition at the retail level ever since 1940" (*1967 Senate Hearings* 26), and that § 22(d) "provides an exemption from the antitrust laws" (*1967 House Hearings* 140). Furthermore, the SEC's view that § 22(d) requires retail price maintenance by broker-dealers who are members of the primary distribution system is also evident in its acceptance of NASD Rule 26(e), which provides that "no member shall offer or sell any such security except at the effective public offering price described in the current prospectus of the issuing company. . . ." CCH NASD Manual ¶ 2176.

The same thread runs through hearings conducted in 1969,[46] again with a view to the modification or repeal of § 22(d). In the 1969 Senate report, we find these comments on § 22(d):

> The provision for "reasonable loads to investors is intended to assure that the sales loads fixed by the principal underwriters (*which continue to be protected against price competition by Section 22(d) of the act*) will be established at levels which recognize the interests of investors.
>
> The provisions of this proposed section shall shall prevail over any conflicting provision of Federal law. This provision, *which is identical*

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[45] *Id.* 21 (letter from Warren Christopher, Deputy Attorney General, to Chairman Harley O. Staggers, October 18, 1967).

[46] *Hearings on S. 34 and S. 296 Before the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. (1969); *Hearings on H.R. 11995, S. 2224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. (1969).

to Section 15A(n) of the Securities Exchange Act, is designed to make it clear that no other provision of Federal law, including the antitrust laws, prevents a registered securities association from adopting rules consistent with, and necessary to effectuate, the purposes and provisions of this section. *S. Rep. No.* 184, 91st Cong., 1st Sess. 18 (1969) (emphasis added).

The basic sales commission charged for mutual fund shares is in most instances about 8½ percent of the total payment or 9.3 percent of the amount invested. *This charge is protected by Section 22(d) of the Investment Company Act which provides for a unique scheme of retail price maintenance. Under this section, all dealers, regardless of the source of the shares they sell, are prohibited by law from cutting the sales charge fixed by the mutual fund underwriter. Price cutting in this field is a Federal crime.*

In its deliberations your committee considered the possibility of deleting Section 22(d) from the act. However, impressive testimony was given that there had not been sufficient study of the consequences of such an amendment. Therefore, your committee requests the Securities and Exchange Commission to review the consequences of such a proposal on both the investing public and mutual fund sales organizations and report to it as soon as is reasonably practicable. *Id.* 7–8 (emphasis added).

It is thus conclusively established that competition in the sale of a single fund's shares is effectively precluded by the 1940 Act which was intended, via § 22(d), to prevent the sale of fund shares at a price less than that fixed in the current prospectus. It is obvious that Section 22(d) of the 1940 Act was premised upon a congressional understanding that principal underwriters and broker-dealers were exempt from the antitrust laws when entering into

uniform sales agreements for mutual fund shares. It is also obvious that even at the expense of a secondary market Congress intended to maintain the resale price maintenance system. Congressional intent is entitled to substantial weight lest this Court "change the design that Congress fashioned." *State Board of Insurance v. Todd Shipyards Corp.*, 370 U.S. 451, 458 (1962).

B. SECTION 22(f)

Section 22(f) is a necessary companion to § 22(d). If the problems of the competitive market created by non-contract brokers were to be met, restrictions on alienability were necessary. And Section 22(f) provides:

> No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

Paraphrased, that language states clearly that if (1) restrictions on transferability or negotiability are included in the registration statement, and if (2) these restrictions are not in contravention of such rules and regulations as the commission may prescribe in the interest of the shareholders, then such restrictions are permissible even if they create departures from antitrust standards.

As noted above in the discussion of § 22(d), Congress considered the 1940 Act in the light of then-existing conditions, particularly the disruptive influence upon the market in mutual fund shares by the practices of non-contract dealers and brokers.

To overcome this disruptive competition prior to the

enactment of the 1940 Act, some funds restricted the alienability of their shares, "providing substantially that the shares could only be sold or tendered for redemption to the open-end investment company."[47] Such restrictions were usually included in the share certificates.[48]

From and after 1940, § 22(f) required that any restriction on alienability be included in the registration statements and, additionally, that they be subject to the rulemaking authority of the SEC. Clearly, by § 22(f) Congress specifically empowered mutual funds to restrict the transferability and negotiability of their shares, subject, of course, to disclosure in registration statements and to the rulemaking authority of the SEC. Just as clearly Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications.

Restrictions on alienability have consistently appeared in registration statements and in uniform sales agreements since the passage of the 1940 Act. Not only are such contracts required by SEC-approved Rule 26 of the NASD Rules of Fair Practice, CCH NASD Manual ¶ 2176, but they are also disclosed in the registration statements. It is undisputed that these agreements have remained virtually unchanged since they were first filed with the SEC along with and as part of the registration statements. It is also undisputed that the SEC has never challenged the validity of uniform sales agreements. Indeed, the SEC has noted that these agreements require a dealer "to place all orders with the principal underwriter and

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[47] *Investment Trust Study of 1940* 865.

[48] *1940 Senate Hearings* 292 (remarks of SEC General Counsel David Schenker).

to refrain from any attempt to obtain shares from other sources."[49]

It is thus apparent that Congress designed §§ 22(d) and 22(f) to create and protect a primary distribution system which is repugnant to the antitrust laws and did so in complete recognition of the fact that the legislation would frustrate the growth of a free secondary market. That statutory scheme is "incompatible with the maintenance of (an) antitrust action." *Silver v. New York Stock Exchange,* 373 U.S. 341, 358 (1963).

Whether the mutual fund marketing structure mandated by Congress in 1940 should be eliminated or modified is an issue for Congress and the SEC, not the Judicial Branch, to hear and to decide. In fact, in urging its complaint upon the Court, one of the plaintiffs, *viz.,* the Department of Justice, seeks to accomplish indirectly what it has failed, so far, to achieve directly—the repeal or modification of § 22(d)—in hearings before both Congress[50] and the SEC.[51]

V

IMPLIED IMMUNITY

Even if a specific exemption granted by the Maloney Act were deemed to be inadequate to grant immunity

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[49] *SEC Staff Report on Repeal of § 22(d)* A-109. *See Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No.* 95, 88th Cong., 1st Sess. 98 (1963), wherein reference is made to the "fair trade arrangements established by the Act, the NASD rules and private sales agreements . . ."; Greene, *Uniform Offering Price, supra,* 37 *U. Det. L.J.* at 371-72.

[50] *1967 House Hearings.*

[51] *In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940,* SEC File No. 4-164 (1973).

from the impact of the antitrust laws, the defendants urge that the 1940 Act, particularly § 22 thereof, created a pervasive regulatory scheme which highlighted the Congressional intent to immunize the investment company industry from the impact of the antitrust laws.

The plaintiffs, on the other hand, urge that repeals of the antitrust laws by implication are "strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." They argue that, in the instant case, plain repugnancy is not apparent.

The most recent pronouncement of the Supreme Court on this particular point is to be found in *Hughes Tool Company v. Trans World Airlines,* 409 U.S. 363 (1973).

In *Hughes Tool* the respondent TWA challenged as violative of the antitrust laws certain transactions and activities of petitioner Hughes Tool (Hughes). The Supreme Court, dismissing the action, held that the challenged transactions "were under the control and surveillance of the Civil Aeronautics Board" (CAB); that pursuant to the Federal Aviation Act of 1968 the CAB applying antitrust standards has reviewed the same kind of conduct which TWA alleged to be violative of the antitrust laws. The Court stated:

> In this context, the authority of the Board to grant the power to "control" and to investigate and alter the manner in which that "control" is exercised leads us to conclude that this phase of CAB jurisdiction * * * pre-empts the antitrust field. 409 U.S. at 385 (footnote omitted).

And the Court further stated that where—

> the CAB authorizes control of an air carrier to be acquired by another person or corporation and where the CAB specifically authorizes as in

> the public interest specific transactions between the parent and the subsidiary, the way in which that control is exercised in those precise situations is under the surveillance of CAB, not in the hands of those who can invoke the sanctions of the antitrust laws. 409 U.S. at 387.

Further the Court said that its holding was "consistent with the view expressed in *Silver v. New York Stock Exchange* . . . that a statutory scheme that does not create a total exception from antitrust laws may, nonetheless, in particular and discrete instances *by implication* grant immunity from an antitrust claim." 409 U.S. at 385 n.14 (emphasis added).

The Court in *Hughes Tool* relied heavily on its prior decision in *Pan American World Airways v. United States,* 371 U.S. 296 (1963), which also involved the pervasive regulatory scheme of the CAB and an implied repeal of the antitrust laws. In *Pan American* the Court found that the Sherman Act could not be applied to matters which the CAB had approved in exercising its statutory function.

> It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of "public interests" as defined in § 2 were held to be antitrust violations. * * * If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide. 371 U.S. at 309–10.

The Court then found that the implementation of antitrust policy in the public interest was for the CAB, under the Federal Aviation Act's comprehensive regulatory scheme, and not for the courts. In the case at bar, as in *Hughes Tool* and *Pan American,* there exists a pervasive regulatory scheme coupled with a legislative history manifesting congressional intent to immunize the investment company industry from the

operation of the antitrust laws to the limited extent necessary to carry out the purpose of the independently defined federal policy legislated in the regulatory act, *i.e.*, the Investment Company and Maloney Acts.[52]

The decisions in *Hughes Tool* and *Pan American* are consistent with the views expressed in *Silver* v. *New York Stock Exchange, supra,* where the Supreme Court held that the Stock Exchange was not exempt from the antitrust laws when, pursuant to its rules, it ordered its members to remove certain telephone connections they had with the offices of a non-member. Although the Exchange was generally regulated by the Securities Exchange Act of 1934, the Court noted that the SEC lacked jurisdiction to review cases such as petitioner's where the Exchange has enforced its rules. *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 358.

The Court's opinion in *Silver* turned on the fact

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[52] In Hecht v. Pro-Football, Inc., 144 U.S. App. D.C. 56, 444 F.2d 931 (1971), *cert. denied*, 404 U.S. 1047 (1972), the Court held the following to be relevant criteria for determining which conduct is immune from the antitrust laws:

"Putting the problem in this light, relevant criteria would include the specific language of the congressional statute involved, any legislative history which would throw light on the congressional intent, the relative importance of the governmental action which is asserted to override antitrust policy, whether the governmental agency is required to take into consideration the possible anticompetitive effect of its actions, whether the agency is required to adhere to a clearly defined and restricted statutory directive, and to what extent the agency's actions are subject to judicial review. 144 U.S. App. D.C. at 60, 444 F.2d at 935.

See also Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264, 270 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971), where the Court also discussed immunity criteria; United States v. Morgan, 118 F. Supp. 621 (S.D.N.Y. 1953).

that there was no justification for the Exchange rule under the Securities Exchange Act because that rule did not provide any procedural safeguards for the petitioner. The Court did find, however, that "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." 373 U.S. at 361. The Court noted further that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented. See note 12, *supra.*" 373 U.S. at 360. The Court's reference, "note 12," refers expressly to the SEC's jurisdiction under the Maloney Act and states that were there such SEC jurisdiction in a *Silver*-type situation, "a different case would arise concerning exemption from the operation of laws designed to prevent anti-competitive activity . . ." 373 U.S. at 358 n.12.[53]

This Court is persuaded that the instant case is that "different case."[54] The Investment Company Act and the Maloney Act read together demonstrate that Congress intended to eliminate free competition in the distribution of mutual fund shares. The language of

[53] *But see* Harwell v. Growth Programs, Inc., 451 F.2d 240 (5th Cir. 1971), *reh. denied*, 459 F.2d 461, *cert. denied*, 409 U.S. 876 (1972), where the Court applied the *Silver* rationale to self-regulatory activities of the NASD. *Harwell*, however, did not involve a claim of limited antitrust immunity under § 22 of the 1940 Act.

[54] *Cf.* Gordon v. New York Stock Exchange, Inc., *et al.*, Civil No. 71-1496 (S.D.N.Y., filed Dec. 4, 1973), where the Court, in dismissing an antitrust attack on the commission structure of both the New York and American Stock Exchanges, found that the fixing of commissions falls within the congressional policy of exchange self-regulation embodied in the Securities Exchange Act of 1934.

both acts clearly defines the pervasive statutory and administrative control over the area and manifests a congressional intent to leave this complex field to the supervision and control of an expert administrative agency.[55] The SEC and the NASD have the statutory authority to control the area and both have in fact taken an active role. The NASD, under the control and supervision of the SEC, has adopted specific rules to govern the activities of principal underwriters and broker-dealers. The Maloney Act, Section 15A(b)(8), specifically requires the SEC to employ antitrust standards, *i.e.,* "to protect the public interest," when reviewing the rules promulgated by the NASD.[56] Still further, the SEC has adopted rules specifically designed to govern *non*-NASD members in the distribution and redemption of mutual fund shares. *See* 15 U.S.C. §§ 78o(b)(8)-(10). In connection with its regulatory function, the SEC has extensively reviewed the distribution and redemption practices in the in-

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[55] In Baum v. Investors Diversified Services, Inc., 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd on other grounds*, 409 F.2d 872 (7th Cir. 1969), the plaintiff alleged a violation of the Robinson-Patman Act. After reviewing the SEC involvement, the court held:

> The foregoing demonstrates that the SEC has exercised its broad regulatory authority in this industry to establish a framework of pricing practices within which investment companies must operate. It has specifically approved the alleged discriminatory pricing system under attack in the case at hand, and has justified the system as being "in the public interest and consistent with the protection of investors and purposes fairly intended by the policy and provisions of this Title." 286 F. Supp. at 924.

[56] *See also* Section 6(c) of the 1940 Act which empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropriate in the *public interest* and

vestment company securities industry and even has reviewed the secondary market for such securities.[57]

This Court's opinion is further strengthened by the Supreme Court's decision last Term in *United States v. Cartwright*, 411 U.S. 546 (1973). That case challenged a regulation issued by the Secretary of the Treasury covering valuation of mutual fund shares for Federal Estate Tax purposes. The Court at least impliedly recognized the pervasive regulatory scheme in the investment company industry.

> Private trading in mutual fund shares is virtually non-existent. Thus at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund at the "asked" price, which includes the load. But shareholders "sell" their shares back to the fund at the *statutorily* defined redemption or bid price. 411 U.S. at 549 (emphasis added).

The Court went on to state that the regulation in question was "manifestly inconsistent with the most elementary provisions of the Investment Company Act of 1940 and operates without regard for the market in mutual fund shares that the Act *created and regulates.*" 411 U.S. at 557 (emphasis added).

The plaintiffs place great reliance on other recent Supreme Court decisions. Principally they rely upon *Otter Tail Power Co.* v. *United States,* 410 U.S. 366

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consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act. 15 U.S.C. § 80a–6(c) (emphasis added).

[57] *See, e.g., Public Policy Report; SEC Staff Report on Repeal of* § *22(d); In the Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4–164 (1973).

(1973), in which the Court refused to imply immunity from the antitrust laws. Plaintiffs cite *Otter Tail* to show that even extensive regulation of an industry does not thereby immunize that industry from the antitrust laws. The Court's language is clear and unequivocal, however, for it found congressional intent *not* to displace the antitrust laws, but rather to retain the applicability in order to promote competition. That is not the case here.

> It is clear, then, that *Congress rejected a pervasive regulatory scheme for controlling the interstate distribution of power in favor of voluntary commercial relationships. When these relationships are governed in the first instance by business judgment and regulatory coercion*, courts must be hesitant to conclude that Congress intended to override the fundamental national policies embodied in the antitrust laws. *See United States* v. *Radio Corporation of America, supra,* at 351. This is particularly true in this instance because Congress, in passing the Public Utility Holding Company Act, . . . was concerned with "restraint of free and independent competition" among public utility holding companies. See 15 U.S.C. § 79a(b)(2). 410 U.S. at 374 (emphasis added).

Otter Tail accordingly is not controlling.

Nor does *Federal Maritime Commission v. Seatrain Lines, Inc.*, 411 U.S. 726 (1973) support plaintiffs' position. That case dealt with the scope of an express repealer of the antitrust laws in the 1916 Shipping Act [58] which by its terms, limited antitrust immunity to conference agreements approved by the Federal Maritime Commission (FMC). At issue was

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[58] 46 U.S.C. § 814. See Note, *The Shipping Industry Seeks a Safe Haven: Merger Jurisdiction for the FMC?*, 5 *Law & Pol. Int'l Bus.* 274 (1973).

whether an agreement which confers no ongoing obligations is an "agreement" within the meaning of the Act. The Court held that Congress did not intend to invest the FMC with the power to shield from antitrust liability mergers which create no continuing responsibilities. Furthermore, the Court found in examining the legislative history there was an overriding federal policy to promote competition. Since the FMC's power to immunize agreements from the antitrust laws was limited only to those agreements approved by it, this Court fails to see in what manner the claim for limited immunity in the present case offends the *Seatrain* principle since there is no similar requirement conditioning exemptions in the 1940 Act.[59]

This Court is not, of course, unmindful of the fact that "(r)epeals of the antitrust laws by implication from a regulatory statute are strongly disfavored, and have only been found in cases of plain repugnancy between the antitrust and regulatory provisions." *United States v. Philadelphia National Bank,* 374 U.S. 321, 350–51 (1963) (footnotes omitted). *See also United States v. McKesson & Robbins, Inc.,* 351 U.S. 305, 316 (1956); *California v. FPC,* 369 U.S. 482 (1962); *United States v. Borden Co.,* 308 U.S. 188 (1939). That principle, of course, rests upon the sound

[59] *Cf.* Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 302–03 n.13 (1973), where the Court recognized that where a regulatory act contains an express exemption from the operation of the antitrust laws, or where a regulatory agency is specifically directed to consider competitive factors in the exercise of its duties, it is necessary to conclude that Congress intended to exempt from the antitrust laws activity subject to the administrative agency's adjudicative or rule-making authority.

Moreover, the cases at bar do not involve the doctrine of primary jurisdiction. *See, e.g.,* Chicago Mercantile Exchange v. Deaktor, 42 U.S.L.W. 3330 (U.S. Dec. 3, 1973) (No. 241); Ricci v. Chicago Mercantile Exchange, *supra.*

basis that "antitrust laws represent a fundamental national economic policy." *Carnation Co. v. Pacific Westbound Conference,* 283 U.S. 213, 218 (1966).[60] With that fundamental policy in mind, the Court does not hold that the Investment Company Act and the Maloney "completely displace the antitrust laws." *Hughes Tool, supra,* 409 U.S. at 389. What the Court does find is a "limited antitrust exemption." *Carnation Co., supra,* 383 U.S. at 219. Here, given the fact that Congress clearly intended to substitute a pervasive regulatory scheme, *i.e.,* § 22 of the 1940 Act, for the usual antitrust prohibitions in the narrow area of distribution and sale of mutual fund shares, it is clear that the price maintenance practices complained of are immune from ordinary antitrust strictures.[61]

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[60] *See, e.g.,* United States v. Borden Co., 308 U.S. 188, 200 (1939). *Cf.* Maryland & Virginia Milk Producers Ass'n Inc. v. United States, 362 U.S. 458 (1960).

[61] Notwithstanding this conclusion, two SEC rulings, cited by plaintiffs in support of their contention that the price maintenance requirements of § 22(d) would not apply if the broker-dealer acted in the capacity of a broker rather than a dealer, deserve mention. One is an Opinion of SEC General Counsel, Investment Company Act Release No. 87 (March 14, 1941). In response to an abstract inquiry, the General Counsel thought that the term "dealer" in § 22(d) "refers to the capacity in which a broker-dealer is acting in a particular transaction." He concluded that when a broker-dealer acts as a broker in a specific transaction, he is not bound to sell at the public offering price. In the Matter of Oxford Co., Inc., 21 SEC 681 (1946), involved a disciplinary proceeding for a broker-dealer alleged to have violated his fiduciary duty to his clients. There the broker-dealer sold mutual fund shares from one of his accounts to another related account, charging the public offering price and retaining the sales load for himself. The SEC, citing the General Counsel's opinion, rejected the technical defense that the subject's actions were mandated by § 22(d).

The Court concludes that reliance on these two decisions is misplaced. They are *ad hoc* decisions in no way related to the

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CONCLUSION

In light of the foregoing, the Court concludes that the plaintiffs in each of the above-captioned cases have failed to state a claim upon which relief can be granted, and that accordingly the motions to dismiss in each such case must be granted. Orders are filed herewith.

H. F. CORCORAN,
Judge.

Dated: DECEMBER 14, 1973.

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regulated distribution system. Furthermore, they do not address the problem of likely discrimination between similarly situated investors. Such shortcomings preclude a basis for allowing industry-wide cut-price competition in brokerage transactions contrary to the purposes of § 22(d).

APPENDIX B

United States District Court
for the District of Columbia

(Civil Action No. 338–73)

UNITED STATES OF AMERICA, PLAINTIFF

v.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., MASSACHUSETTS INVESTORS GROWTH STOCK FUND, INC., FIDELITY FUND, INC., WELLINGTON FUND, INC., THE CROSBY CORPORATION, VANCE, SANDERS & COMPANY, INC., THE WELLINGTON MANAGEMENT COMPANY, INC., MERRILL LYNCH, PIERCE FENNER & SMITH, INC., BACHE & COMPANY, INC., REYNOLDS SECURITIES CORPORATION, E. I. DUPONT, GLORE FORGAN, INC., E. F. HUTTON, INC., WALSTON & COMPANY, INC., DEAN WITTER & COMPANY, INC., PAINE, WEBBER, JACKSON & CURTIS, INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., DEFENDANTS

Filed DECEMBER 14, 1973.

JAMES F. DAVEY,
Clerk.

ORDER

This matter having come on for ruling on the defendants' motions pursuant to Rule 12 of the Federal Rules of Civil Procedure to dismiss the complaint for failure to state a claim upon which relief can be granted, the parties having filed briefs in support of their respective positions, and the Court being fully advised in the premises and having issued its Memorandum Opinion on December 14th, 1973;

It is this 14th day of December, 1973,

Ordered That the above-captioned case be, and the same is, hereby dismissed on the merits and with prejudice for failure to state a claim upon which relief can be granted.

H. F. CORCORAN,
Judge.

APPENDIX C

United States District Court,
District of Columbia

(Civil Action No. 338-73)

UNITED STATES OF AMERICA, PLAINTIFF

v.

THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL., DEFENDANTS

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN That the United States of America, plaintiff herein, appeals to the Supreme Court of the United States from the judgment for defendants entered December 14, 1973.

This appeal is taken under the Expediting Act, 15 U.S.C., Sec. 29.

Dated at Washington, D.C. FEBRUARY 11, 1974.

DANIEL R. HUNTER,
Attorney for Plaintiff.

U.S. GOVERNMENT PRINTING OFFICE: 1974

No. 73-1701

IN THE

Supreme Court of the United States

October Term, 1973

United States of America, *Appellant*

v.

National Association of Securities Dealers, Inc., et al., *Appellee*

On Appeal From the United States District Court For the District of Columbia

MOTION TO AFFIRM OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1701

UNITED STATES OF AMERICA, *Appellant*

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., ET AL., *Appellee*

On Appeal From the United States District Court For the District of Columbia

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MOTION TO AFFIRM OF APPELLEE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Appellee National Association of Securities moves, pursuant to Rules 16(1)(c) and 16(1)(d) of the Rules of this Court, that the judgment of the District Court be summarily affirmed. The decision below is so plainly

correct and the issues raised by appellant are so insubstantial as not to require plenary review. The opinion and order of the District Court are set forth in Appendices A and B, respectively, to the Jurisdictional Statement.[1]

STATEMENT

This is an appeal from a judgment dismissing a complaint which alleged violations of the Sherman Act in connection with the distribution of securities of open-end investment companies or mutual funds as they are commonly called. The National Association of Securities Dealers, Inc. ("the NASD") was named as a defendant in one count of the complaint.

1. The NASD is a creature of Section 15A of the Securities Exchange Act of 1934, 15 U.S.C. 78o-3. Section 15A, the so-called Maloney Act of 1938, supplements the regulation of the over-the-counter securities markets by the Securities and Exchange Commission ("the Commission"). Section 15A provides a system of cooperative regulation of the over-the-counter markets through voluntary associations of brokers and dealers. The NASD, which is the only such association, currently has approximately 3300 members of whom about half are primarily engaged in the sale of mutual fund securities. The NASD is subject to a reticulated pattern of statutory regulation, including comprehensive review and supervision by the Commission. As more fully pointed out below, the rules of the NASD, for example, must satisfy prescribed statutory standards which, *inter alia,* deal with anti-competitive prac-

[1] The time for filing a motion to affirm the appeal was extended to and including July 15, 1974.

tices, and provision is made for antitrust immunity. Section 15A thus embodies an accommodation of the policies of securities laws and those of the antitrust laws.

In addition to its general, over-the-counter, regulatory responsibilities under the Maloney Act, with the enactment of the Investment Company Act ("the Act") in 1940, 15 U.S.C. 80a-1 *et seq.*, the NASD was vested with authority over the pricing of shares of mutual funds.

2. A mutual fund is essentially a managed portfolio of securities. It is characterized by the fact that it issues a redeemable common stock under an obligation to pay the holder his proportionate share of the market value of the fund's net assets.[2] In effect, this redemption right provides a ready "market" for a selling shareholder. Because of the redeemability feature, mutual funds generally make a continuous offering or a primary distribution of their common stock in order to prevent their assets from shrinking. The offering price per share, which is described in the fund's prospectus, consists of the net asset value per share, which is computed at least once a day, plus a sales charge or sales load in the case of the type of funds here under consideration. This public offering price is sustained by a retail price maintenance provision in Section 22(d) of the Act, as discussed below.

The method of primary distribution of these shares, both before and since the passage of the Act, has been basically as follows: The mutual fund grants the ex-

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[2] Sections 2(a)(32), 5(a)(1) and 22(e) of the Act, 15 U.S.C. 80a-2(a)(32), 5(a)(1) and 22(e).

clusive right to purchase shares from the fund to a principal underwriter, who generally acts only as a wholesaler, and leaves the retailing to dealers, who enter into an agreement with the underwriter. The principal underwriter and the retail dealer divide the sales load component included in the public offering price, and the mutual fund receives the net asset value.

In addition, as discussed below, a secondary over-the-counter, inter-dealer market, in which issued and outstanding mutual fund shares are traded, has existed both before and after the passage of the Act. This has never been a brokerage market.

STATUTE INVOLVED

Section 22 of the Investment Company Act, 15 U.S.C. 80a-22, is set out in its entirety in the Appendix hereto.

THE POSITION OF APPELLANT

The NASD is named only in Count I of the complaint. That count alleges that the NASD and its members have maintained a combination and conspiracy in violation of Section 1 of the Sherman Act, 15 U.S.C. 1.

1. In naming the NASD, appellant labored under basic misconceptions about the Maloney Act, the NASD itself, its rules and its activities. Following the NASD's explanation of these matters below, appellant made a hasty retreat, and repudiated the keystone of its complaint against the NASD.

Appellant still finds itself in the same anomalous posture. Thus, as appellant states (Jur. St. 7), the complaint alleges that "to effectuate the conspiracy", the NASD "establish[ed] and maintain[ed] rules which had the effect of inhibiting the development of the sec-

ondary dealer and brokerage markets." But, then, in a total disavowal, appellant states (Jur. St. 26): "The complaint challenges no rule or regulations of the NASD . . ." Moreover, it even concedes that no NASD rule has the effect alleged in the complaint!

Appellant's same misconceptions permeate as well the relief it seeks (Compl. Prayer, ¶¶ 6 and 7). Its request that the NASD be enjoined from establishing and maintaining rules is predicated on the thesis it has now abandoned. Moreover, this prayer was obviously fashioned without regard to the detailed rule making standards, including procedures and Commission oversight, embodied in a web of provisions in the Maloney Act and the Investment Company Act, over which the Commission has exclusive jurisdiction, as discussed below. Without regard as well to the regulatory plan of the Investment Company Act for pricing, the complaint would also enjoin the NASD from fixing the price in a mutual fund transaction, which the NASD has not in any event done. The complaint would even require the NASD to include in its manual to members references as to brokerage transactions that appellant now acknowledges are already there (Jur. St. 20, n. 21).

In essence, by virtue of appellant's own acknowledgements, its misconception saturated complaint is but an apparition.

2. But whatever the allegations in this regard, appellant's underlying approach is premised on a lack of appreciation of the scope, impact and purpose of the pricing provisions of the Investment Company Act. This is particularly evident, for example, in the fact that it blinds itself, in its purported analysis of the statute (Jur. St. 16-19), from the amendments enacted